



## California Public Employees' Retirement System

Operations Summary  
Comprehensive Annual Financial Report  
Year Ended June 30, 1996

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# Introduction

CalPERS experienced another exceptional year in investment returns, benefit program administration, and management of our health benefits program.

Much of our progress this year flowed from the adoption of the CalPERS Strategic Plan, a road map for meeting challenges as we head toward the 21<sup>st</sup> century.

Woven through this year's annual report is an outline of this Strategic Plan. Each section of this report provides an insight into our eight strategic goals and outlines some of the first important steps we are taking to achieve these goals.

This plan was designed to ensure that CalPERS is operating in the best possible manner to meet the challenges of the next five years. It was developed with input from individuals and groups who have a stake in benefits administration in the future.

As you read the Operations Summary and Comprehensive Annual Financial Report, we hope you will see not only our progress for the year ended in June 1996, but that you will also be pleased with our first steps toward meeting our ambitious goals. Our "focus" is sharp, and our commitment is firm as we strive for superior performance, cost-effective management, and quality service for all of our customers.

## **CALPERS STRATEGIC PLAN GOALS**

- I. We will be mission driven.
- II. We will sustain a high performance work culture.
- III. We will make our programs, processes, and strategic directions understandable to our stakeholders and highly valued by our internal and external customers.
- IV. We will use our resources effectively.
- V. We will continuously meet or exceed internal and external customer quality-of-service expectations.
- VI. We will design, develop, and deliver our programs and benefits to be innovative and market sensitive.
- VII. We will have a positive public identity and relationship with our external customers and stakeholders.
- VIII. We will effectively organize and focus resources to primarily assure that sufficient funds are available to pay benefits and, to secondarily minimize and stabilize employer contributions.

# Financial Highlights

**WE WILL USE OUR RESOURCES EFFECTIVELY.** Resources will be efficiently organized and focused to support effective management of the System. – Goal IV

## PUBLIC EMPLOYEES' RETIREMENT FUND (UNAUDITED)

	1996	1995
<b>Assets</b>		
Cash & Cash Equivalents	\$9,104,357	\$6,508,779
Investments, at Fair Value	99,984,935,915	87,781,948,360
Receivables	2,349,973,820	2,211,423,575
Other Assets	82,081,880	88,634,564
<b>Total Assets</b>	<b>\$102,426,095,972</b>	<b>\$90,088,515,278</b>
<b>Liabilities</b>	<b>\$726,978,755</b>	<b>\$649,379,569</b>
<b>Net Assets Held in Trust for Pension Benefits</b>	<b>\$101,699,117,217</b>	<b>\$89,439,135,709</b>

## ADDITIONS & DEDUCTIONS

	1996	1995
<b>Additions</b>		
Member Contributions	\$1,338,044,978	\$1,290,624,208
Employer Contributions	1,850,103,438	1,578,933,781
Investments Income	13,135,454,838	12,502,185,919
Other	1,747,245	2,342,343
<b>Total 1996 Additions</b>	<b>\$16,325,350,499</b>	<b>\$15,374,086,251</b>
<b>Deductions</b>		
Retirement, Death, & Survivor Benefits	\$3,846,390,136	\$3,557,486,924
Refunds	138,296,520	130,668,331
Administrative Costs	80,682,335	67,697,488
<b>Total 1996 Deductions</b>	<b>\$4,065,368,991</b>	<b>\$3,755,852,743</b>
<b>Increase in Net Assets Held in Trust for Pension Benefits</b>	<b>\$12,259,981,508</b>	<b>\$11,618,233,508</b>

Complete financial information of all the Funds administered by CalPERS can be found in the Comprehensive Annual Financial Report for the year ended June 30, 1996.

## President's Message

**WE WILL BE MISSION DRIVEN.** We will use our strengths to establish and maintain our leadership role—first, for the benefit of our external customers—and second, to effectively respond to the needs of our stakeholders. – Goal I

### Dear CalPERS Member and Stakeholder:

I am pleased to report that in fiscal year 1995-96, CalPERS completed development of a Strategic Plan to carry us into the 21<sup>st</sup> century. Flexible and ambitious, the plan is the result of two years of comprehensive analysis of the financial, social, and service issues facing our customers and our System. No program or process was overlooked in the detailed analysis undertaken. We reviewed both the internal structure of CalPERS and the external pressures on our decision-making process. We reviewed our most basic fiduciary responsibilities, and sought to find new ways to harness information technology in order to bring world class service to our more than one million members and the thousands of public sector employers that depend on CalPERS.

Building on the strength, stability, and innovation that has made the System a leader for the past 65 years, the Strategic Plan that has been developed includes a new mission statement and solid principles to guide our work as we move forward. We have wasted no time in getting started. Annual plan goals and strategies, focused on continuous improvement, have been developed. We have maintained our customer service focus, furthered our investment objectives, and undertaken a variety of new initiatives designed to enhance member retirement and health security.

During fiscal year 1995-96, we put several building blocks of change in place. We launched our first centralized information technology project which ultimately will enable employers and members to access CalPERS information using only their phone, a modem, and their personal computer. We began to build an actuarial software system that will provide our employers with an unparalleled actuarial valuation system that will surely become the industry standard. Additionally, we have put all the services we provide employers under one organizational unit umbrella for greater efficiency.

While we reaffirmed our asset allocation strategy, we emphasized risk management with on-going examination of the relationship between our assets and our liabilities. We recognized that



for real change to occur, we need to ensure that we will sustain a high performance work culture. We started down this path with the establishment of a Change Management Office to facilitate the coaching and training of employees to work collaboratively to achieve our goals.

It was also an exceptional year in terms of investment returns and program performance. This was the year in which the CalPERS Fund crossed the \$100 billion mark—a milestone in dollar growth and an important reminder of the distance we will need to go to fund retirement benefits exceeding an estimated \$34 billion a year by the year 2024. It was the fourth consecutive year we kept health premium costs down, while adding substantial improvements in quality of care. We exceeded our own expectations in the popularity of our new Long-Term Care Program and our marketing efforts helped continue steady growth in our Public Agency Deferred Compensation Program.

It was a year of major improvement in communications with our members, employers, and stakeholders. We continued our very popular member retirement seminars, improved our annual member statements, and expanded our regular publications for members and employers. We intend additional improvements in the year ahead as we strive to meet another Strategic Plan goal—to make our programs, processes, and strategic directions understandable and valued by all.

In summary, for the past year the CalPERS Board of Administration has worked especially hard to seek high investment returns while carefully managing risk. With the leadership provided by a very committed Board and the continued professionalism and dedication of staff, I am confident that we will be able to meet the critical challenges we will face in the future. CalPERS members, beneficiaries, and employers will see continued improvements in financial strength, retirement stability, and unparalleled service through innovation. With our focus sharpened through the establishment of our Strategic Plan, and with the support of our members and stakeholders, our aims are achievable.

Respectfully submitted,

A handwritten signature in black ink, reading "William Dale Crist". The signature is fluid and cursive, with a large, stylized "W" and "D".

William Dale Crist, President  
CalPERS Board of Administration

## Year in Review

**WE WILL SUSTAIN A HIGH PERFORMANCE WORK CULTURE** that is responsive to internal and external customer needs... Employees will perform in a proactive, innovative, values-driven manner. – Goal II

During fiscal year 1995-96, CalPERS began putting the building blocks in place to achieve our goals of becoming highly responsive, innovative, and market sensitive.

### CUSTOMER SERVICE ADVANCEMENTS—EMPLOYERS

CalPERS is dedicated to bringing about a quantum leap in customer service during the next five years. One of the first steps occurred this year, when CalPERS consolidated five separate functions serving employers into a “one-stop shop.” Today, employers have their own designated team within the new Actuarial and Employer Services Division. Each team provides personal service of all kinds—from specialized employer training, to payroll processing, as well as actuarial support services.

In addition, employers began receiving on-line computer access to CalPERS to view or make changes to their membership data. Known as the Member Action Request System (MARS), it is the beginning of an effort to create an easy-to-use, paperless information system, which will provide more effective and efficient benefits administration for employers and members.

Beginning in March 1996, the City of Roseville was the first to use MARS to view and make real-time changes to membership data via computer.

*The first steps toward paperless benefits administration were realized when the City of Roseville became the first employer to input on-line, real time membership changes through the innovative MARS program. CalPERS representatives, Terrie Boyd (left) and Steve Propp, assisted Roseville Personnel Technician, Candi Fligge, in getting “on-line”.*

### CUSTOMER SERVICE—ACTIVE, INACTIVE, AND RETIRED MEMBERS

One way in which customer service is measured is the type of service provided over the telephone. During the last fiscal year, CalPERS received over 170,000 calls in the Benefit Application Services area alone. An astounding 95.3 percent of those callers got through without a busy signal and those who





had to wait for an operator, waited on average 1 minute, 40 seconds.

Those wanting information on the CalPERS Health Program were able to make their telephone calls free this year, with the institution of a new toll-free telephone number. As a result, even more customers called this year than in the past.

The more than 233,000 customers who called the CalPERS Post Retirement Services Division also received a higher level of service. Last year, staff focused on directing customers to appropriate specialists. This year, there are more customer service assistants available and each handles a number of processing tasks directly.

In an effort to provide the most cost-effective way to reach members needing financial planning, CalPERS introduced two new no-cost financial planning seminars. Members receive information on a variety of topics from identifying financial goals, budgeting and debt control, to insurance, tax planning, and estate planning.

Every CalPERS active and inactive member receives a CalPERS Annual Member Statement. This past year, the statements provided more details than ever, in an easy-to-understand format. Improvements included a better display of service credit history, information on reciprocal system membership, and estimates of future retirement benefits, where appropriate.

California's volunteer firefighters received more information about CalPERS Volunteer Firefighters' Length of Service Award System this year. As a result, this System became stronger than ever, with contributions totaling more than \$1 million.

## **STRENGTHENING THE FUND THROUGH INVESTMENTS**

Again this year, the Board of Administration reaffirmed an asset allocation policy which shifted more assets into higher performing equities. The decision paid off, resulting in substantial earnings. On May 14, 1996, the CalPERS Fund crossed the \$100 billion mark. It is noteworthy because the System will need to pay benefits for the great numbers of employees who will be retiring or retired.

## **ADDING SHAREHOLDER VALUE THROUGH INTERNATIONAL CORPORATE GOVERNANCE**

The Board also approved an expanded role in shareholder activism with the establishment of an International Corporate Governance Program designed to enhance returns on investments. If the international program is as successful as our Domestic Corporate Governance Program, these activities could add an estimated \$150 million a year in extra returns on investments.

In an effort to help ensure maximum returns in each of the separate asset classes, the Board also authorized the hiring of senior investment portfolio managers for the private equity, fixed income, and real estate classes. Two of the three managers were on board by the end of the fiscal year. The third will be retained during fiscal year 1996-97. Each is responsible for a comprehensive review of their specialized portfolios and for developing proposed strategies to help maximize returns for the years to come.

## Year in Review

### CALPERS ESCALATES QUALITY OF CARE AS AN ISSUE ON ITS HEALTH PROGRAM AGENDA

The CalPERS Strategic Plan calls for ensuring affordable health plan premiums and good quality health care.

This year, CalPERS has been even more active on the health care front. We successfully negotiated health care premiums below the national average, with Health Maintenance Organization (HMO) premiums reduced by 1.4 percent, the fourth decrease in as many years. HMO Supplement to Medicare and Managed Medicare plan premiums decreased an astounding 38.5 percent.

As a result of the savings in Managed Medicare premiums, retirees in these plans received new benefits, including hearing aid coverage and a \$1 prescription copayment.

All members benefitted from the development of the easy-to-use CalPERS Health Plan Quality/Performance Report. This report includes data from the 1995 Exit Survey, which shows why members changed plans and why others chose to remain with their plans.

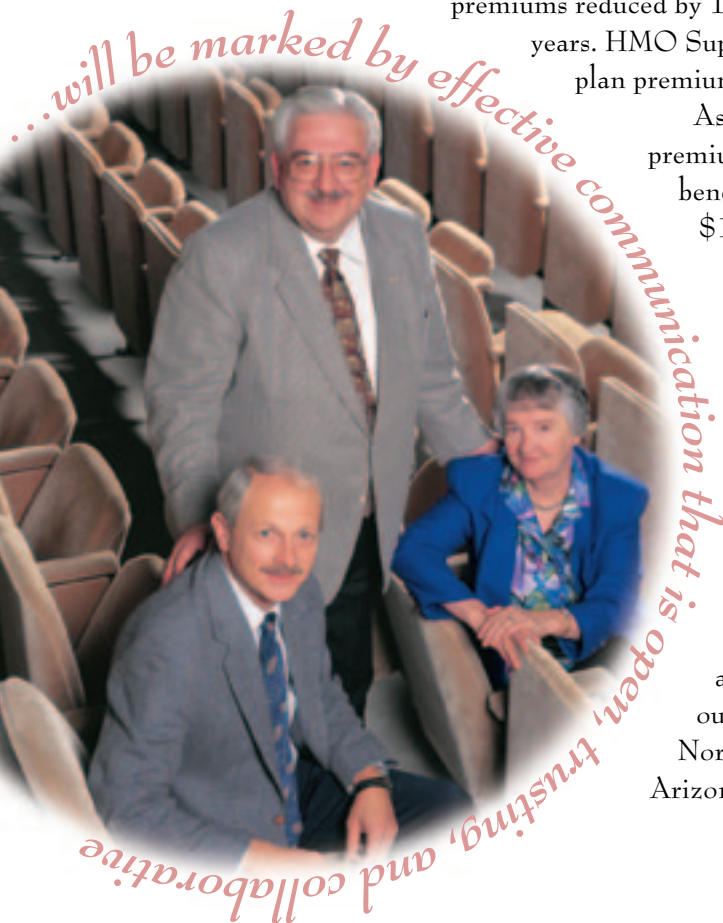
In an effort to ensure that there is quality access to health care for all our members, CalPERS worked to expand health care choices for members who reside in rural areas of California and for members who live out-of-state. This effort helped members in Del Norte County and those now living in parts of Arizona, particularly.

### LONG-TERM CARE AND DEFERRED COMPENSATION PROGRAMS

Last year, CalPERS responded to a major unmet customer need—how to finance a long-term illness. Such needs can have devastating financial effects. (An average annual nursing home stay costs \$44,000; or at-home, assisted-care expenses of \$20,000 for families who need to hire a caregiver.)

At the beginning of 1995, CalPERS came to the rescue with a new program—the

*Teamwork and information sharing were the foundation of our Strategic Plan development. CalPERS staff and stakeholders worked collaboratively to develop a road map for future success. Wilma Krebs, California State retired faculty representative, Board Member Charles P. Valdes (standing), and Office of Long-Term Care Chief Tom Fischer, continue this relationship by regularly discussing benefit issues.*





CalPERS Long-Term Care Program. It is the first not-for-profit, self-funded program in the United States and focuses on delivery of care, not just financing a prolonged stay at a nursing home or a lengthy stay at home with assisted care. By the close of fiscal year 1995-96, CalPERS enrolled almost 40,000 members in the program.

The Public Agency Deferred Compensation Program is another CalPERS service designed to help members add to their retirement savings. Deferred compensation allows a member to shelter a portion of their salary from income tax and direct their money into investment options of their own choice.

The full-service Deferred Compensation Program was offered for the first time to public agency employers and their employees in fiscal year 1994-95, and this year, many more joined the program. An average of five new agencies a month offered this program as a benefit for their employees during the year, with more than \$1 million a month being added to the deferred compensation investment pool. The growth came about as a result of efforts by CalPERS staff to make this program well known to public agency employers.

#### **PREVENTING FRAUD AND ABUSE**

CalPERS Board and staff undertook additional steps to enhance protection of the Fund against fraud and abuse. The Office of Audit Services was reorganized to strengthen the independent appraisal function that examines and evaluates all CalPERS activities. The Legal Office, working in cooperation with the Benefit Application Services Division, developed a pilot "Disability Validation Team" designed to screen certain disability retirement applications to ensure they are legitimate.

In fiscal year 1995-96, the Board strengthened its own ethics and conflicts of interest requirements by adding additional rules governing official travel and expenses and by approving a new policy affecting potential contractors, who now must disclose any financial relationships with past or present CalPERS officials prior to being considered for a contract with the System.

#### **SEEKING EXCELLENCE IN OPERATIONAL EFFECTIVENESS**

Perhaps no single program change is as comprehensive as the System's efforts to modernize its management information systems for the next century. During fiscal year 1995-96, CalPERS undertook an ambitious program to speed up our ability to retrieve information and serve our members through the Integrated Corporate Database Project. According to the Legislative Analyst's Office, the new system being phased in at CalPERS is one of the few within State government that could serve "as useful models for technology efforts" in all State agencies. The ultimate objective is to have a comprehensive, coordinated management information system that will quickly provide members and employers with the most up-to-date, reliable, and complete information possible.



*CalPERS Board of Administration from left to right: (front row) Jerry Cremins, William Rosenberg, Lillian Rowett (representative for David Tirapelle), Charles P. Valdes; (second row) Thomas J. Clark, William D. Crist, Matt Fong, Michael Flaherman; (third row) Ronald Alvarado, Kathleen Connell, Robert F. Carlson; (back row) Harry Bubbs, Kurato Shimada.*

# CalPERS Board of Administration

**William D. Crist**

President  
Employee Member  
(elected by State members)  
Professor, CSU—Stanislaus  
Term Ends: January 15, 1999

**Jerry Cremins**

Public Representative<sup>2</sup>  
President, State Building &  
Construction Trades Council  
of California  
Term Ends: January 15, 1996

**Charles P. Valdes**

Vice President  
Employee Member  
(elected by all members)  
Counsel, Department of  
Transportation  
Term Ends: January 15, 1998

**Kathleen Connell**

State Controller  
Ex Officio Member

**Michael Flaherman**

Employee Member  
(elected by public agency members)  
Economist, Bay Area Rapid Transit  
Term Ends: January 15, 1999

**Ronald Alvarado**

State Personnel Board Member  
(designated by the State  
Personnel Board)  
Term Ends: Serves at the pleasure  
of the State Personnel Board

[[ **Richard Carpenter** ]]  
[[ Thru January 1996 ]]

**Matt Fong**

State Treasurer  
Ex Officio Member

**William Rosenberg**

Employee Member  
(elected by all members)  
Retired—Retirement Specialist,  
CalPERS  
Term Ends: January 15, 1998

**Harry Bubb**

Official of Life Insurer<sup>1</sup>  
Chairman Emeritus, Pacific Mutual  
Life Insurance  
Term Ends: January 15, 1997

**Kurato Shimada**

Employee Member  
(elected by school members)  
Landscape/Grounds Supervisor,  
Oak Grove School District  
Term Ends: January 15, 1999

**Robert F. Carlson**

Retired Member  
(elected by retirees)  
Retired—Chief Counsel,  
Department of Transportation  
Term Ends: January 15, 2000

**David Tirapelle**

Director, State Department of  
Personnel Administration  
Ex Officio Member

**Thomas J. Clark**

Elected Official of Local Government<sup>1</sup>  
Former Councilman,  
City of Long Beach  
Optometrist  
Term Ends: January 15, 1999

**Notes:**

<sup>1</sup> Governor appointee.

<sup>2</sup> Appointed jointly by the Speaker of the Assembly  
and the Senate Rules Committee.

# CalPERS Board Committees

**IN ADDITION TO THEIR REGULAR DUTIES, BOARD MEMBERS** also serve on permanent and ad hoc committees to review specific programs, projects, or issues and make recommendations to the Board. The following committees were active as of June 30, 1996.

## **Benefits & Program Administration**

Michael Flaherman, Chair  
Ronald Alvarado, Vice Chair  
Robert F. Carlson  
Kathleen Connell  
William D. Crist  
Matt Fong  
William Rosenberg (Chair thru February 1996)

This committee reviews all matters related to benefit program structure, actuarial studies and rate setting, retirement program policy, and administrative issues.

## **Executive Performance & Compensation**

Robert F. Carlson, Chair  
Thomas J. Clark, Vice Chair  
Harry Bubb  
William D. Crist  
Charles P. Valdes

This committee studies and evaluates compensation mechanisms and criteria, develops policies and procedures, and makes recommendations to the Board concerning compensation of key personnel.

## **Finance**

Robert F. Carlson, Chair  
Kathleen Connell, Vice Chair  
William D. Crist  
Michael Flaherman  
Matt Fong  
David Tirapelle  
Charles P. Valdes

This committee provides financial oversight on all budget matters, evaluates funding alternatives, oversees preparation

and recommends approval of the CalPERS budget, and oversees the CalPERS annual and periodic audits by both internal and external audit units.

## **Health Benefits**

Kurato Shimada, Chair  
Charles P. Valdes, Vice Chair  
Harry Bubb  
Kathleen Connell  
Jerry Cremins  
Matt Fong  
David Tirapelle

This committee oversees the administration of the Public Employees' Medical & Hospital Care Act program.

## **Investments**

Charles P. Valdes, Chair  
William D. Crist, Vice Chair  
Ronald Alvarado  
Harry Bubb  
Robert F. Carlson  
Thomas J. Clark  
Kathleen Connell  
Jerry Cremins  
Michael Flaherman  
Matt Fong  
William Rosenberg  
Kurato Shimada  
David Tirapelle

This committee reviews investment transactions, the investment performance of both internal and external managers, and establishes investment policy and strategy.

## **Investments Subcommittees:**

### **Policy**

David Tirapelle, Chair  
Robert F. Carlson  
Charles P. Valdes

This subcommittee conducts an inventory of all existing investment policies, procedures, and guidelines for review by the Investment Committee. It reviews and recommends revisions to these on a priority basis. This subcommittee is also charged with developing a manual of policies, procedures, and guidelines, and a process for periodic revisions.

### **Real Estate**

Michael Flaherman, Chair  
David Tirapelle, Vice Chair  
Robert F. Carlson  
Thomas J. Clark  
Jerry Cremins  
William Rosenberg  
Charles P. Valdes

This subcommittee develops real estate investment portfolio strategies, policies, and procedures for Investment Committee approval.

### **Strategic Planning**

David Tirapelle, Chair  
Michael Flaherman, Vice Chair  
Harry Bubb  
Thomas J. Clark  
Kathleen Connell  
Matt Fong  
William Rosenberg

This committee oversees the strategic planning process, including selection of consultants, defining process direction, and monitoring development of the CalPERS Strategic Plan.

## **Other Committees**

### **Ad Hoc Committee to Review Board**

#### **Information Requirements**

Michael Flaherman, Chair  
Robert F. Carlson  
William Rosenberg  
Kurato Shimada  
Charles P. Valdes  
(Vacant)

This committee determines what information the Board requires, organization and presentation of that information, frequency, and distribution. The committee also reviews technology to improve, develop, disseminate, and reduce the overall cost of providing information to the Board and other parties.



*Resources will be efficiently organized and focused to support effective management within CalPERS dynamic employee benefit system environment.*

*CalPERS Executive Staff from left to right: (front row) Robert Aguallo; (second row) Kayla Gillan, James Burton, Sandra Lund, Vincent Brown; (third row) Ron Seeling, Patricia Macht, Robert Walton; and (back row) Sheryl Pressler, Margaret Stanley.*



# CaLPERS Staff

## EXECUTIVE OFFICE

**James E. Burton**

Chief Executive Officer

**Richard H. Koppes**

Deputy Executive Officer &  
General Counsel  
(Thru July 30, 1996)

**Robert Aguallo**

Assistant Executive Officer  
Investment Office

**Vincent P. Brown**

Assistant Executive Officer  
Financial & Administrative Services

**Kayla Gillan**

General Counsel (as of August 27, 1996)

**Sandra C. Lund**

Assistant Executive Officer  
Member & Benefit Services

**Patricia K. Macht**

Chief, Office of Public Affairs

**Sheryl Pressler**

Chief Investment Officer  
Investment Office

**Ron Seeling**

Chief Actuary

**Margaret Stanley**

Assistant Executive Officer  
Health Benefit Services

**Robert D. Walton**

Assistant Executive Officer  
Governmental Affairs,  
Planning & Research

## DIVISIONS

**Tom Britting**

Chief, Office of Audit Services

**Tom Fischer**

Chief, Office of Long-Term Care

**Pat Harris**

Chief, Benefit Application Services

**Barbara Hegdal**

Chief, Member Services

**Mitzi Higashidani**

Chief, Information Technology Services

**Gary M. Jones**

Chief, Field Services

**Michael Koester**

Chief, Operations Support Services

**Ron Kraft**

Chief, Fiscal Services

**Ken Marzion**

Chief, Actuarial & Employer Services

**Susan L. Myers**

Chief, Legislative & Federal Relations

**Chris Nishioka**

Interim Chief, Post Retirement Services

**Michael Ogata**

Chief, Planning & Research

**Tom Pettey**

Chief, Human Resources

**Steve Phillips**

Chief, Change Management Office

**Michael Priebe**

Chief, JRS, LRS, & VFF Programs

**Fred Steinmetz**

Interim Chief, Health Plan  
Administration

**Janet Toney**

Chief, Health Benefit Services

## AREA & FIELD OFFICES

**Nancy Carter**

Manager, Sacramento Area Office

**Elaine Edwards**

Manager, San Diego Field Office

**Debra Gibson**

Manager, Orange County Field Office

**(vacant)**

Manager, San Bernardino Field Office

**Pat Largent**

Manager, San Francisco Area Office

**Charles McClamma**

Santa Clara County Field Office

**Steve Pietrowski**

Manager, Fresno Field Office

**Cora Williams**

Manager, Los Angeles Area Office

## Providing Benefits

**WE WILL MAKE OUR PROGRAMS, PROCESSES, AND STRATEGIC DIRECTIONS** understandable to our stakeholders and highly valued by our internal and external customers. We will increase education and promote open communication. – Goal III

CalPERS provides a variety of retirement benefit services for members—administering service and disability retirements, refunds to members who leave CalPERS-covered employment, purchases of additional service credit, and death benefits. We also offer general education and informational services, so members can responsibly plan for their retirement years. In fiscal year 1995-96, CalPERS served well over one million members, working with and through employers. This year more than 2,400 public agencies partnered with CalPERS to provide quality benefits administration.

CalPERS paid nearly \$4 billion in total benefits this year. This amount is expected to grow tremendously in future years as a maturing work force becomes eligible for benefits. It is estimated by the year 2024, more than \$34 billion will be needed annually to pay benefits. CalPERS expects to fund this growth in benefit obligations through its investments, employer contributions, and employee contributions which will continue to increase the size of the Fund. CalPERS is presently more than 95 percent funded.

For a pension fund the size of CalPERS, service is constantly a top priority. At CalPERS, there are nine different benefit formulas, with 55 separate contract options. There are 21 different types of service credit members can purchase, with seven different costing methods. As such, it is no wonder that CalPERS pays particular attention to providing customers with accurate, detailed information.

Those serving CalPERS members are proud of our service record. For example, during fiscal year 1995-96, eight out of 10 members received their first service retirement allowance payment within 30 days of their retirement date. Seven out of 10 disability retirement applicants received their final papers within 30 days of approval. An

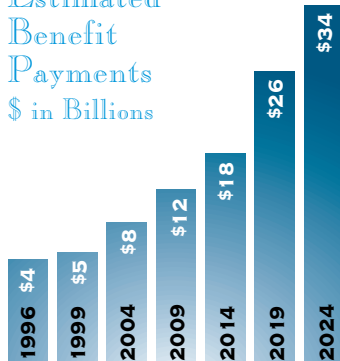


*Being responsive to all those we serve is the foundation of our commitment to customer service. Assisting members to understand their benefits is our business. Jackie Martinez (left), Field Services representative, provides one-on-one service to retiree Dale Coleman and his wife, Luella.*

estimated 94 percent of beneficiaries received monthly death benefits within three months of notification of a member's death.

Each year, CalPERS provides a variety of seminars to help members, including information on the importance of financial and estate planning, as well as information on tax planning, CalPERS benefits, and Social Security. After an extensive review of our existing seminars, CalPERS developed no-cost programs for members of all ages. By the end of the year, 128 seminars will have been conducted for almost 8,000 members and their spouses.

**CalPERS  
Estimated  
Benefit  
Payments  
\$ in Billions**



The most common way CalPERS members and employers contact the System is through our telephone information centers. More than 40 CalPERS staff handled well over 400,000 calls dealing with member and benefit questions. Over 86 percent of the callers got the information they wanted without having to be referred to someone else within CalPERS. This is due to a variety of improvements staff

initiated this year, including additional phone lines, extended hours, the institution of 24-hour voice mail, new computer-assisted aids, and software designed to improve call routing.

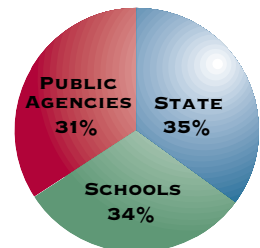
CalPERS made some significant improvements in telephone service for retirees too. More phone lines were installed and staff was added who began assuming more processing tasks including Golden Handshake adjustments, direct deposit requests, address changes, and the issuance of tax withholding forms.

CalPERS expects many more changes in the future to ensure smooth administration of benefits. The Actuarial and Employer Services Division began what will be the most sophisticated actuarial valuation program in the country. The development of software began in June 1996 and will be completed next fiscal year.

During the year, CalPERS also implemented the Member Action Request System (MARS). This system allows employers to enter and transmit member information electronically. It was piloted with the City of Roseville and by the end of the fiscal year was in use in four public agencies.

Our advancements provide today's members with a good measure of security for their future retirements and allows those now retired the ability to enjoy their well-deserved leisure.

**Membership  
by Employer**



#### **RETIREMENT (PERF) PROGRAM FACTS**

- 726,039 active and inactive members
- 337,131 retirees, beneficiaries, & survivors
- 16,487 new retirees
- \$3.83 billion paid in benefits
- 2,405 contracting public agency employers (includes school districts)

## Adding Value and Security

**WE WILL CONTINUOUSLY MEET OR EXCEED INTERNAL AND EXTERNAL CUSTOMER QUALITY-OF-SERVICE EXPECTATIONS.** We will work to be a customer-service based organization by working with our customers to understand their needs. – Goal V

Retirement should be a special time, but many people look toward it with a bit of anxiety. The comfort of being a CalPERS member is that we are there to provide the best services and benefits possible, making retirement as secure as possible. Besides the security of a defined benefit, CalPERS members are also eligible for a number of programs that add value to a secure financial future. Among them is the CalPERS Long-Term Care Program.

This program provides extended care for chronic illnesses, which can quickly deplete the financial resources of most members.

The care associated with chronic illnesses can cost a member thousands of dollars, with the average annual cost of a nursing home stay estimated at \$44,000. This self-funded insurance program completed its first application period on June 30, 1996, with more than 40,000 public employees and their families enrolling.

The program provides comprehensive coverage with features at a cost estimated to be 20 to 30 percent less than plans offered by conventional insurance carriers. The program has premiums exceeding \$34 million and is now the largest self-funded program in the nation. Its enrollments place it among the top 10 percent of all long-term care insurance providers in the nation. As a result of the success of the first application period, the CalPERS Board voted to establish a second application period beginning in April 1997.

Another “value added” program administered by CalPERS is the PERS 457 Deferred Compensation Program. This program was developed last fiscal year for local public agencies. The investment options are designed to be suitable for retirement savings and are broadly diversified across a range of investment categories. By the close of the fiscal year, 140 public agencies have offered this

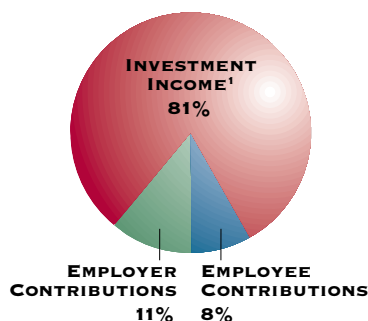
program to their employees. CalPERS staff continued through the year to solicit local agency employers to make this benefit available to their staff.

*Our Deferred Compensation Program offers CalPERS members an additional way to ensure a secure financial future. Marty Walton (center) and Georganna Griffin often participate in trade shows and employee conventions throughout the State talking about this savings program.*



Employees of the State of California are able to obtain similar retirement savings by investing their income through the Savings Plus Program, managed by the Department of Personnel Administration (DPA). CalPERS offers three funds through the DPA program, providing State employees with the benefits of CalPERS investment returns.

## CalPERS Income



Another supplement to retirement savings offered to State employees by CalPERS is the Supplemental Contributions Program. While contributions to this program are made with after-tax dollars, the earnings received are tax deferred.

Contributions are invested with the CalPERS investment portfolio, ensuring the CalPERS net earnings rate.

CalPERS members also receive added value through their ability to help secure a home loan. Through the CalPERS Member Home Loan Program, 100 percent financing can be obtained, with a 95 percent real estate loan and a 5 percent personal loan secured by the member's retirement contributions. During the year, this Program purchased approximately 3,000 real estate loans totaling \$405 million and nearly 2,000 personal loans of \$14 million.

Since the Home Loan Program's inception in

1981, over 40,000 real estate loans have been made, equaling \$4.8 billion. The

Personal Loan Program, which began in 1994, has made over 4,000 loans totaling approximately \$26.5 million.

CalPERS programs not only help members buy homes, they have a substantial impact on the California economy. Through the CalPERS Single Family Housing and the Acquisition & Development Programs more than 2,300 construction jobs have been created and 3,000 homes built. Approximately 60 percent of the homes built are considered entry level homes.

## Total Membership Five Year Review

1992	958,283
1993	979,468
1994	1,009,234
1995	1,045,615
1996	1,063,170

### CALPERS PROGRAM FACTS

- More than 40,000 members enrolled in the Long-Term Care Program
- Long-Term Care Program premiums exceed \$34 million
- 140 agencies participating in the Public Agency Deferred Compensation Program
- \$405 million loaned through the CalPERS Member Home Loan Program
- \$14 million loaned through CalPERS Member Home Loan Program/Personal Loan Program

#### Note:

<sup>1</sup> Includes gains in fair market value in investments and gains in sales of securities.



## To Your Health

**WE WILL DESIGN, DEVELOP, AND DELIVER OUR PROGRAMS AND BENEFITS** to be innovative and market sensitive. We will create a menu of programs based on the real needs of customers, as well as market conditions. – Goal VI

As the largest purchaser of health care in California—the second largest in the nation—CalPERS continues to stand at the forefront of change in health care delivery. Our advancements are proving to not only benefit CalPERS members, but all Californians, and the health care industry as a whole. For as we make the “system” work for us, we make it work for everyone.

With nearly one million Californians in the CalPERS Health Program, the tasks before us remain affordable premiums, good quality care, and satisfied patients. As we ride the tide of changes in health care delivery and the industry, CalPERS has instituted “value-based purchasing”—the optimal combination of quality, service, and cost.

For the fourth straight year, CalPERS negotiated premium decreases of 1.4 percent, with the addition of 1.2 percent added benefit value. Eight of our Managed Medicare plans added a hearing aid benefit and a \$1 prescription copayment. Several of our Basic plans added chiropractic coverage and two plans added annual eye exams. HMO Supplement To Medicare and Managed Medicare premiums alone decreased an average of 38.5 percent and health plan choices were expanded for those living in California’s rural areas and out-of-state. But cost is only one component of our value equation.

During the 1995-96 fiscal year, CalPERS turned its leadership focus to improvements in quality of care and customer service. Internally, a new toll-free phone service was initiated, allowing members greater ease in reaching the System. In total 125,000 health benefits calls were handled during the year. We also experienced one of the largest open enrollment periods ever, with more than 26,000 transactions processed.

Enhanced technology has made it easier, faster, and less expensive for public agency employers to electronically “deposit” premiums for their employees, reducing costs for check processing, reconciliation, and

*Provide a health program which is flexible and responsive to the competing needs of all members*

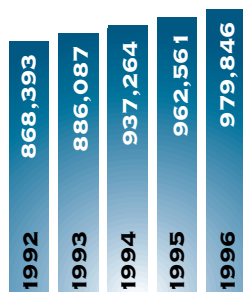
*Every parent wants the best for their children. The bottom line in the CalPERS Health Program is offering quality health care. CalPERS member, Heather Huerta, her daughter Hannah, and physician Dr. Henry Chang, work together as a “team”, ensuring the family’s well being.*



postage. In a new quality initiative, the Managed Prior Authorization Program was implemented in our self-funded plans, PERSCare and PERS Choice, prescription drug program. This program ensures that certain drugs are used effectively and in accordance with specific clinical criteria for medical appropriateness. We want to make sure patients get the best drugs available for them.

## Total Health Program Membership

### Five Year Review



Dynamic changes in the managed care industry were witnessed in plan mergers, changes in State and federal laws, questions on relationships between health plans and physicians and physicians and patients, and movements for mandated industry improvements.

During the year, CalPERS pursued its partnership—working together with health plans—to develop mechanisms ensuring both quality and satisfaction, as solutions to policy issues unfold.

CalPERS health plan contracts now contain measures to monitor customer access to services, the plan's ability to provide care, and their financial status. "Disease management" initiatives are being established to proactively seek out those who can benefit most from preventive measures in areas such as cardiovascular disease.

CalPERS continued to work with health plans

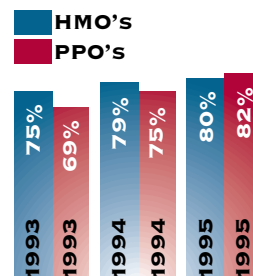
during the year to assure that members can get physician appointments in a reasonable time and make it easier to get a referral to a specialist when needed. These areas were noted by our members in a satisfaction survey we conducted as those in need of immediate improvement.

As the future comes in focus, CalPERS intends to be a strong patient advocate. Someone needs to speak for the patient and we will take that role. Provider network instability will no longer be allowed to interrupt patient care. Excessive executive compensation and plan mergers that threaten our ability to reach our "value quotient" will be scrutinized. Incentives that discourage the medical community from providing the right level of care at the right time for as long as necessary will also be examined. And CalPERS will continue to monitor the debate on Medicare and Medicaid reform.

Our goal is to have those who provide health care—the plans and the purchasers—work together to focus on the health care needs of the patients and the health of California as a whole.

## Health Plan Satisfaction Trends

### Three Year Review



## HEALTH PROGRAM FACTS

- 979,846 participants
- 65 percent of participants are State members
- 35 percent of participants are school and public agency members
- 1,078 participating public agencies
- \$1.5 billion paid in health care premiums
- Nearly 130,000 enrollment documents processed annually

## Investments

**WE WILL EFFECTIVELY ORGANIZE AND FOCUS RESOURCES** to primarily assure that sufficient funds are available to pay benefits and, to secondarily minimize and stabilize employer contributions. We will integrate assets and liabilities in determining strategies. – Goal VIII

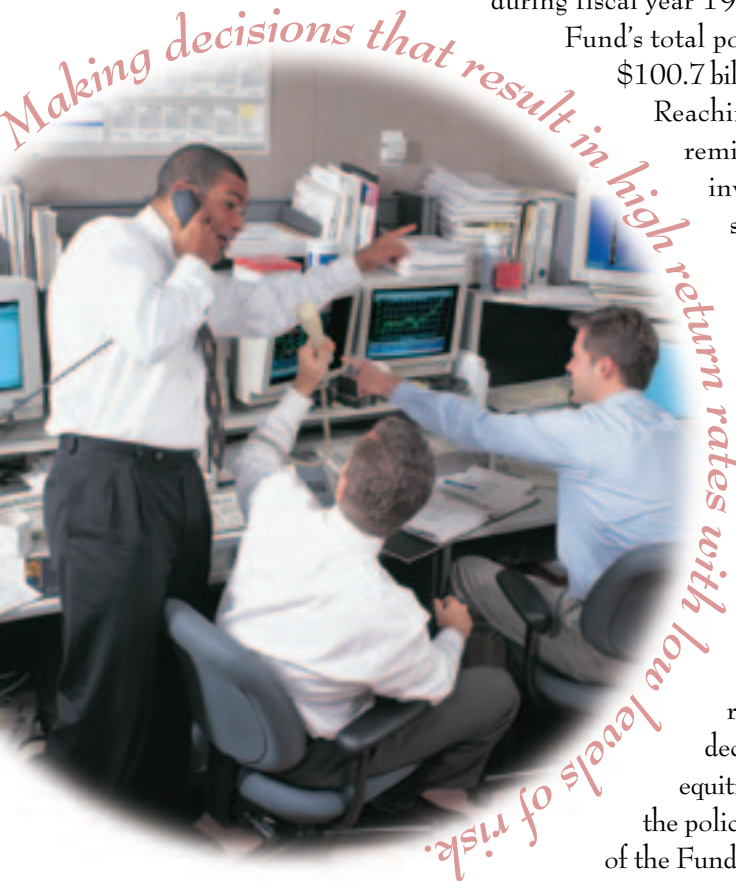
### INVESTMENT PROGRAM OVERVIEW

CalPERS investment portfolio reached a historic milestone during fiscal year 1995-96 hitting the \$100 billion mark. The Fund's total portfolio market value as of June 30, 1996 was \$100.7 billion, posting an impressive return of 15.3 percent.

Reaching this symbolic milestone served as a reminder to our members that, first and foremost, investments in the Fund are safe and growing steadily over the long term to ensure that sufficient funds are available to pay benefits.

The CalPERS Board of Administration's decision to reaffirm the System's strategic asset allocation policy was largely responsible for the Fund's strong performance. This policy, which was originally adopted in December 1994, increased the Fund's equity allocation to 63 percent and reduced the fixed income allocation to 30 percent. Simultaneously, the U.S. stock market enjoyed one of the greatest booms ever during the year as the Dow Jones raced past 5,000 in November 1995, less than a decade after it hit 2,000. As a result, our domestic equities earned a 25.6 percent return. The benefits of the policy proved significant, as the strong performance of the Fund helped to minimize and stabilize contributions required by employers and employees to maintain benefits.

This year marked the 11<sup>th</sup> season of the Fund's successful corporate governance activism. For a third year, the CalPERS Board adopted a two-tier approach to the program, targeting 10 "focus" companies and increased monitoring of 26 other poorly performing companies. An extensive study conducted by Wilshire Associates examined the effect of CalPERS Corporate Governance. Updated results provided to the System during the year



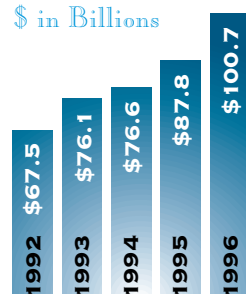
*Diligence and innovation continue to help the CalPERS investment portfolio grow. We take this responsibility seriously since steady growth will ensure the funds needed to pay future benefits are available. CalPERS staff Tony Ives, Todd Smith, and Carl Guidi (left to right) monitor market activities of the Fund in our headquarters "trading" room.*

indicated that for a five-year period, CalPERS corporate governance activism in the U.S. contributed significantly to the companies' performance. These were com-

## Growth in Portfolio - Market Value

Five Year Review

\$ in Billions



panies that trailed the Standard & Poor's (S&P) 500 by 85 percent five years prior to CalPERS efforts, and outperformed the index by more than 33 percent in the five years following our activism.

To fulfill our fiduciary obligation to exercise our ownership rights abroad and increase returns to the Fund, we launched a formal International Corporate Governance Program in March 1996. The Board agreed to focus its efforts initially in the four countries with the highest equity exposure: Japan, United Kingdom, Germany, and France. The System began to develop a culturally sensitive international program that shares experiences and reaches consensus on how corporate governance can work in each country.

To ensure continued strong earnings and prudent management of risks into the 21<sup>st</sup> century, CalPERS implemented some investment operational improvements during the year. The recruitment of two senior investment officers to oversee the Fund's alternative investment and real estate portfolios allowed for specialized oversight and management of these programs. With this leadership in place, the System began thorough reviews of our real estate, private equity, and alternate investments. Strategies for each portfolio began to be developed in 1996.

The Fund's alternative and private equity investments provided strong results during the year, earning 9.8 percent and 15.2 percent, respectively, while the real estate portfolio slightly underperformed the National Council of Real Estate Investment Fiduciaries (NCREIF) Index benchmark earning 7.9 percent vs. 8.1 percent. The underperformance was a result of continued mediocre investment performance by the real estate market.

In addition, CalPERS consolidated its Real Estate Mortgage Unit with its Fixed Income Unit to ensure an efficient and effective investment process. The System's total fixed income portfolio earned 5 percent, exceeding the Salomon Brothers Large Pension Fund Index of 4.5 percent.

Of equal importance, the Fund's strong performance results came at a low cost to the System. According to a study issued by Cost Effectiveness Measurement, Inc. (CEM) in December 1995, CalPERS investment operation costs of 11.2 basis points were below the 13.2 basis point median of its peer group comprised of other large multi-million dollar corporate and public pension funds according to data compiled during the 1995 calendar year. The cost of portfolio managers and other consultants amounted to a little more than one-tenth of one percent of the Fund's value.

Our cost effective and efficient investment management operations were also recognized by the State. In June 1996, the California Department of Personnel Administration once again awarded CalPERS the contract to manage the S&P 500 Index Fund for the Savings Plus Program. CalPERS manages \$103 million in assets for the Program.

Fulfilling our commitment to seek investments that strengthen California's economy, we continued a proactive approach in making prudent investments in the State. Through a number of programs including private equity investments, limited partnerships, single family

# Investments

housing, land acquisition and development, home loans, and external manager contracting, CalPERS has diversified while driving California's economic growth. Approximately \$12.9 billion has been committed by the System for investment in California.

## INVESTMENT POLICY & STRATEGY

The Board has investment authority and sole responsibility for the management of assets. A complete set of regulations serves as a guide for the Board's Investment Committee, CalPERS management, and staff for carrying out the daily activities of the investment program. Investment policies are formally reviewed through the System's Investments Policy Subcommittee and receive final approval by the Investments Committee.

The following investment objectives have been established for the portfolio.

### Inflation

Achieve a total portfolio return of 4 percent in excess of the U.S. Consumer Price Index.

### Actuarial

Achieve a total portfolio return above the assumed actuarial interest rate, currently 8.5 percent for the period July 1, 1995 through June 30, 1996.

### Performance

1. For the internal equity index portfolio, achieve a return equal to the Wilshire 2500 Index, plus or minus 50 basis points.
2. For externally managed assets, meet specific performance objectives related to each manager's investment style, which are outlined in their contract(s).
3. For internal domestic fixed income instruments, achieve a return in excess of the Salomon Brothers Large Pension Fund Index.

4. For equity real estate, achieve at least a 5 percent real rate of return.

## ASSET ALLOCATION

The starting point and most important component for CalPERS to achieve successful returns on investment—large or small—is its asset allocation decision. In the long run, it is the way the Fund diversifies stocks, bonds, cash, and other investments that is largely responsible for the System's returns. The asset allocation decision is not an asset-only or liability-only decision. All factors, including liabilities and contributions, are taken into account in determining the appropriate asset allocation mix. The Board approves a target allocation with range guidelines for each asset class.

There are two types of asset allocations: strategic and tactical. Strategic asset allocation is the basis for long-term asset allocation targets for each asset class. Within each asset class, ranges are included in the policy to provide the flexibility to take advantage of market opportunities. Information is received from staff, research services, and money managers. The information serves as the basis for tactical asset allocation which allows shifts between classes to take advantage of emerging or rapidly developing market opportunities.

## CORPORATE GOVERNANCE & CORPORATE RELATIONS

With over a decade passed since our emergence as a leader in shareholder-corporation dialogue, CalPERS Corporate Governance Program is at a pivotal developmental stage. Perhaps the most important question, as we seek to define corporate governance for the future, is what has the movement achieved? And are the results sustainable in the future?

During the first half of the fiscal year, CalPERS asked these fundamental questions—both externally and internally—as part of its strategic re-evaluation of our Corporate

Governance Program. As a result, we concluded that activists must continue to be involved in corporate governance. But, to continue to be effective, this involvement must change.

We refocused our energies. First, we included more of the “stragglers” in corporate America—the smaller companies that have not yet paid substantive attention to governance issues and that are underperforming their industry peers.

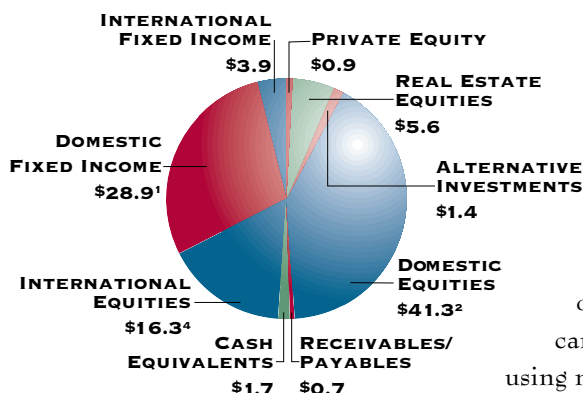
Second, we acknowledged the possibility—where necessary to ensure director accountability for management oversight—of engaging in assertive “vote no” campaigns against incumbent directors and of using more extensive proxy solicitation to support shareholder proposals than have been used in the past.

Third, we continued to focus on board structural issues, with an expansion into board performance—both individual and collective. We began to examine the quality of individual board members and whether their efforts have added value to the company.

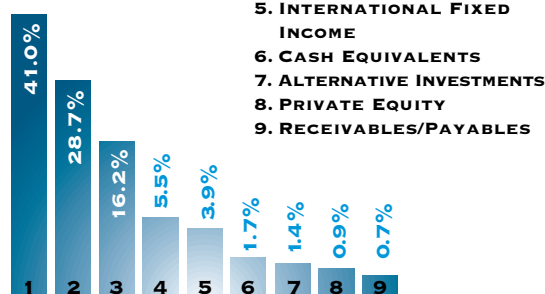
Finally, in a major expansion of our governance efforts, we launched a formal International Corporate Governance Program. Given the increase of international equities that are being added to the Fund, adoption of the program was a logical and necessary step to increase the monitoring of our foreign securities and fulfill our fiduciary obligation to exercise our ownership rights abroad. The System began to construct its international governance efforts through key leaders within those countries, with CalPERS participating in a supporting role that is respectful of the unique cultures and financial structures of the countries.

## Investment Portfolio- Market Value

\$ in Billions



## Investment Mix by Asset Class



### Notes:

<sup>1</sup> Includes all internally managed portfolios that include a small percentage of equities.

<sup>2</sup> Includes all internally managed portfolios that include a small percentage of fixed income.

<sup>3</sup> Includes domestic fixed income securities held in the externally managed global asset allocation portfolios.

<sup>4</sup> Excludes cash managed internally.



# Investments

## INTERNAL EQUITY INVESTMENTS

The Board's decision to increase the Fund's allocation to equities continued to help performance as the equity markets outpaced the bond market over the long-term, which is the Fund's horizon. CalPERS believes the shift into equities is a natural and necessary response to the demographic realities that we face.

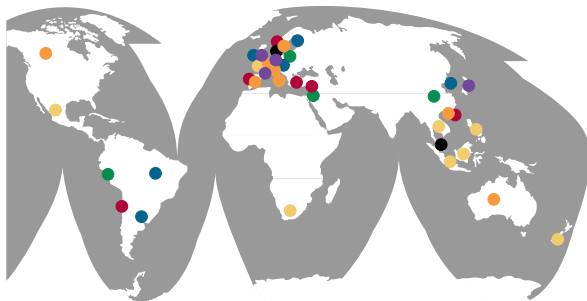
Of the \$41.3 billion in domestic equity, approximately 84 percent are internally managed in an indexed portfolio designed to provide the return of the Wilshire 2500

Index of 26 percent for the one year period ending June 30, 1996. The strategic objective is to

obtain broad domestic equity market exposure by closely tracking the designated benchmark index. Performance of the System's domestic equities was very close to the benchmark—earning impressive returns of 25.6 percent.

Quantitative methods for portfolio management and computer systems for trading are extensively utilized in the management of the System's internal equity investments.

## CalPERS International Investments



<p><b>Up to \$25 Million</b></p> <p>China Israel Luxembourg Peru</p>	<p><b>\$300 - \$500 Million</b></p> <p>Denmark Malaysia</p>
<p><b>\$25 - \$50 Million</b></p> <p>Chile Greece Norway Portugal Taiwan Turkey</p>	<p><b>\$500 Million - \$1 Billion</b></p> <p>Australia Canada Hong Kong Italy Netherlands Spain Sweden Switzerland</p>
<p><b>\$50 - \$100 Million</b></p> <p>Argentina Austria Brazil Finland Ireland Korea</p>	<p><b>Over \$1 Billion</b></p> <p>France Germany Japan United Kingdom</p>
<p><b>\$100 - \$300 Million</b></p> <p>Belgium Indonesia Mexico New Zealand Philippines Singapore South Africa Thailand</p>	

## EXTERNAL MANAGERS

The selection of external managers affords the Board the opportunity to acquire portfolio management expertise not available internally and to gain the diversification of distinctly separate strategies and approaches to investment of the Fund.

Approximately 16 percent of the domestic equity portfolio—6.5 percent of the total CalPERS portfolio—is managed by 11 external managers. The objective of the active domestic equity program is to achieve returns in excess of the S&P 500.

In addition, CalPERS total international investment program is managed externally, using 14 investment managers. Eight of the managers are equity managers, including seven active international equity



managers and one passive international equity index fund manager. Four of the managers are international fixed income managers, while the remaining two are global asset allocators. The Board also contracts with two currency overlay managers to manage a portion of the currency exposure of CalPERS passive international equity investments. The total international investment program comprises approximately 20 percent of CalPERS total portfolio. Of the managers in the global investment program, only the two global asset allocators are allowed to invest in U.S. securities.

The foreign countries in which CalPERS is invested are:

#### **Europe**

Austria	Luxembourg
Belgium	Netherlands
Denmark	Norway
Finland	Portugal
France	Spain
Germany	Sweden
Greece	Switzerland
Ireland	Turkey
Italy	United Kingdom

#### **Pacific Basin**

Australia	Malaysia
China	New Zealand
Hong Kong	Philippines
Indonesia	Singapore
Japan	Taiwan
Korea	Thailand

#### **Latin America**

Argentina	Chile
Brazil	Peru

#### **North America**

Canada	Mexico
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#### **Other**

Israel	South Africa
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It is expected that countries will be added to the list as new markets open up.

## **DOMESTIC FIXED INCOME INVESTMENTS**

Domestic fixed income is comprised of U.S. Treasury, corporate, securitized and non-securitized mortgage-backed securities, and other types of mortgage loans representing \$28.9 billion. Performance of the System's domestic fixed income investments was 5 percent, which slightly exceeded the Salomon Brothers Large Pension Fund (LPF) Index that returned 4.5 percent.

While the international bond markets performed only somewhat better than the U.S. market, active portfolio management was able to add value to the Fund. Over five years, annualized performance for total fixed income including domestic and international was 10.3 percent, which again exceeded the LPF benchmark of 9.5 percent.

## **ALTERNATIVE INVESTMENT PROGRAM AND PRIVATE EQUITY INVESTMENTS**

In fiscal year 1995-96 a senior investment officer for the System's alternative and private equity investments was added. Under the direction of the Chief Investment Officer, the senior investment officer began a thorough review of the System's private equity portfolios and began preparing for the development of an investment strategy.

The Board has allocated 3 percent of the total Fund for investment in alternative assets and a 2 percent to private equity investments. The alternative and private equity investment programs have combined commitments of \$4.4 billion, of which over \$2 billion was invested.

Alternative investments include a broad range of investment opportunities which require commitment of capital over extended periods of time, usually 10 years. These investments are made through participation as

# Investments

a limited partner in an investment fund. In addition, these commitments require four or more years to invest the capital allocated to the partnership. Also included in this area are alternative emerging investments which involve new, non-traditional investments, including first-time funds, certain emerging markets, and California-targeted investments.

Approximately \$3.8 billion of the System's portfolio is committed to alternative investments and have been made in a core of experienced partnerships that have proven performance track records. CalPERS has committed to 71 partnerships with 58 sponsoring organizations. Of these, approximately 36 percent of committed dollars to be invested are to partnerships residing in California.

Private equity investments are directly negotiated purchases of equity and equity-related securities from private or publicly traded entities. As opposed to investing in publicly traded equities, we retain discretion over the form and terms of the investment instrument and are responsible for the negotiation, structuring, and monitoring of the investment.

CalPERS private equity investment has developed more slowly and includes three direct investments and two coinvestments with total commitments of \$596 million.

In both alternative investments and private equity, the investments are typically long-term positions that are expected to provide significant returns over periods of nine years or longer. They increase the diversification of the total portfolio, contributing to the enhancement of return and the reduction of risk.

## REAL ESTATE INVESTMENTS

At the end of the fiscal year, the real estate equity portfolio was valued at \$5.6 billion and comprised 5.5 percent of the total Fund. The portfolio is managed in two distinct components that include core and specialized real estate investments.

During the fiscal year, a senior investment officer was hired to manage the System's real estate investments and develop an overall strategy for the portfolio. The goal of real estate investments is to generate attractive risk adjusted returns, diversify risk of the overall mixed asset portfolio, and provide an inflation hedge when real estate markets are in equilibrium.

The System's core real estate investments offer numerous benefits in a mixed-asset portfolio by reducing risk through diversification, providing an expected risk-adjusted return between public debt and equities, and generating cash flow. Approximately \$3.8 billion—or 67 percent of the total real estate portfolio—is core real estate which includes investments in apartment, industrial, retail, and office properties.

CalPERS specialized real estate portfolio primarily targets higher returns in niche opportunities and includes specialized investments of \$1.8 billion in housing, timber, and franchise finance.

The real estate program is managed internally, with a 7 percent fund target allocation established by the Board. Twenty-two external managers are utilized for real estate equity placements. In addition to traditional real estate placements, CalPERS continued to originate new programs and investments which aid California's economy and provide appropriate risk-adjusted returns.

CalPERS Single Family Housing Program continues to generate new home construction in California, generating returns for the System of approximately 20 percent. In addition, the System has invested approximately \$77 million in its Acquisition & Development Program, a residential land development program exclusive to California. Further, CalPERS Member Home Loan Program, which provides up to 100 percent financing on home mortgages, has purchased over 40,000 loans totaling \$4.8 billion dollars since its inception in 1981. Of CalPERS total real estate investments, approximately \$1.9 billion are invested in California.

## **SECURITY ANALYSIS & RESEARCH**

The Securities Analysis & Research Unit provides in-house research, analysis, and recommendations in the areas of fixed income, equity, private equity, real estate, and corporate governance to assist in making investment decisions. Ongoing monitoring of fixed income securities and real estate transactions includes annual industry reviews. Staff review all existing fixed income holdings and provide an industry overview.

The Research Unit also provides the initial screening, analysis, and recommendations regarding the selection of underperforming companies for the CalPERS corporate governance activities and provides analysis on selected target companies. Other responsibilities of this Unit include review of corporate actions, including mergers, acquisitions, and tender offers, as well as review of private equity transactions.

# Legislative Highlights

**WE WILL HAVE A POSITIVE PUBLIC IDENTITY AND RELATIONSHIPS WITH OUR EXTERNAL CUSTOMERS AND STAKEHOLDERS.** We want to be considered as a trustworthy, equitable, cost-effective, responsive, and well-managed organization. – Goal VII

## STATE UPDATE

During the year, the CalPERS Board of Administration adopted Legislative Policy Standards providing general policy principles. In keeping with the Strategic Plan, these principles serve as a guide to staff and the Board in formulating positions on legislative proposals. The Board's duty to its participants and beneficiaries takes precedence over any other duty.

The following is a brief summary of CalPERS-related legislation, which was enacted during the second year of the 1995-96 Session of the California Legislature. (New laws become effective January 1, 1997, unless otherwise noted.)

### **AB 166, Chapter 318 (Cannella)**

Continues a CalPERS-administered program permitting school districts to provide Medicare coverage to members of the State Teachers' Retirement System hired prior to April 1, 1986 until June 30, 1999. (Effective July 29, 1996.)

### **AB 2400, Chapter 1164 (Miller)**

Provides that part-time employees, who are CalPERS members (other than local safety members), not vested in CalPERS, and working less than half time during a fiscal year, can be placed in an alternative retirement system, if the employer has established one, and the represented employees have agreed through collective bargaining to be subject to this action.

### **AB 3478, Chapter 1120 (Aguilar)**

Allows the spouse of any deceased local safety firefighter or peace officer who died in the line of duty to receive the pre-retirement monthly death benefit for life,

*Creating relationships of trust ensures legislative actions are cost-effective and efficient for all those concerned. Senate Consultant David Felderstein and Senator Teresa Hughes (from left to right) work closely with CalPERS Legislative Services Chief Susan Myers and Assistant Executive Officer Robert Walton on activities affecting CalPERS members and stakeholders.*



regardless of their current or future marital status. The new law also requires local employers to continue to provide employer-sponsored health benefits to eligible spouses and dependents of local safety firefighters or peace officers who die in the line of duty. (Effective September 30, 1996.)

**SB 468, Chapter 927 (Mello)**

Creates a new administrative procedure between the Department of Social Services and CalPERS to collect delinquent court-ordered child, family, or spousal support payments from members or beneficiaries.

**SB 713, Chapter 171 (Maddy)**

Revises property tax provisions of the Revenue & Taxation Code, allowing county assessors to annually collect property taxes on CalPERS-owned properties, rather than each time a possessory interest is created, such as when building tenants change. (Effective July 17, 1996.)

**SB 1494, Chapter 482 (Dills)**

Amends the Public Employees' Medical & Hospital Care Act to allow eligible judges, who retire under the Judges' Retirement System II, to continue health coverage upon assuming responsibility to pay the employer contribution. This statutory change also clarifies that a nonmember shall have no further community property interest in the JRS II Fund upon dissolution of marriage to a member.

**SB 1859, Chapter 906 (Alquist)**

Renumbers the California Public Employees' Retirement Law in accordance with the 1995 Law recodification.

**SB 1877, Chapter 680 (Rogers)**

Changes the law to comply with federal statute concerning refunds for members electing to participate in the State Second-Tier retirement plan. Amended California law to conform with federal mandates (Uniformed Services Employment and Re-employment Rights Act of 1994) on leaves of absences from employment, such as military service.

**SB 1945, Chapter 502 (Craven)**

Prohibits the trustee of a CalPERS contracting agency that has filed for bankruptcy under Chapter 9 from ending its contract with CalPERS, retaining the contracting agency's liability for its retirees' allowances. This law also allows any California public agency, regardless of whether it contracts with CalPERS for retirement coverage, to participate in the CalPERS deferred compensation program.



# Legislative Highlights

## FEDERAL UPDATE

CalPERS closely watched developments at the federal level for changes in policy or programs which could impact System participants and worked in conjunction with other pension plans, employer and employee groups, and labor and retiree organizations in addressing issues of significance to CalPERS and its stakeholders.

During the second year of the 104<sup>th</sup> Congress, CalPERS scored major legislative victories with the enactment of long-sought changes to Sections 415 and 457 of the Internal Revenue Code and tax benefits for enrollees in the CalPERS Long-Term Care Program.

CalPERS has sought to protect the System and its beneficiaries from significant harm because of unintended consequences in the application of the U.S. tax code. Historically, the application of Internal Revenue Code Section 415 to public pension plans failed to reflect the important differences between public and private sector plan structures, sponsors, and participants. In response, CalPERS successfully sought reform of Section 415 to reflect the unique characteristics of public plans. Also, Section 457 plans are now indexed annually to reflect cost-of-living increases. This change put plan beneficiaries on a level playing field with beneficiaries of 401(k) plans used mostly in the private sector. In addition, Section 457 assets and income will be required to be held in trust for the exclusive benefit of CalPERS participants and beneficiaries—instead of governmental employers' own accounts.

A major accomplishment in 1996 was passage of the Kennedy-Kassebaum health insurance reform bill, H.R. 3103. This measure contained a long-term care

section to encourage individuals to purchase long-term care commercial insurance contracts. Under this new law, individuals who purchase long-term care commercial insurance contracts will be able to deduct the cost of premiums. Additionally, the value of benefits received will not be taxed as income. Since the CalPERS long-term care benefits are provided through a self-funded program and are not commercial insurance contracts, CalPERS was successful in having language added to H.R. 3103 to ensure that our enrollees would benefit from the favorable tax treatment.

In 1997, all signs indicate that interest in pension security among elected officials will increase, particularly as concerns over Social Security and Medicare move into the legislative spotlight. Last year, federal lawmakers of both political parties pursued a record number of pension-related initiatives. If comprehensive federal tax reform gains momentum, CalPERS and other public plans will move aggressively to protect against changes that could negatively impact retirement security.

# CalPERS Profile

With assets having an estimated market value of \$100 billion, the California Public Employees' Retirement System (CalPERS) is America's largest public pension fund, the third largest in the world.

Headquartered in the State's capital, Sacramento, CalPERS provides retirement and health benefit services to more than one million people and more than 2,400 public employers. The System also operates seven offices located in San Francisco, Los Angeles, Orange County, San Bernardino, San Diego, Santa Clara County, and Fresno.

We're in the service business—and we've been at it for some time. CalPERS was established by 1931 legislation as a retirement system for only State employees, effective January 1, 1932. In 1939, other public entities were allowed to contract with the System to provide retirement benefits. Classified school employees also became eligible in 1939. In 1962, the Public Employees' Medical & Hospital Care Act authorized CalPERS to provide health coverage for State workers. Five years later, this program was expanded to include local public agency employees on a contract basis.

While CalPERS is guided by State law, the CalPERS Board of Administration and our 1,000 employees work on behalf of our customers—our most important asset.

## ON THE COVER

*Customer service is at the heart of our focus. Building relationships, providing quality service, and going the extra mile. CalPERS Health Plan Administration representative, Michelle Mitchell (right), assists Ann Hartley who retired from the Department of Transportation.*